

REVENUE ESTIMATES

The May Revision forecasts that baseline General Fund revenues will be lower than at the Governor's Budget by \$3.1 billion in 2011-12 and by \$1.2 billion in 2012-13. Figure REV-01 shows the baseline revenue forecasts, by source, in the Governor's Budget and the May Revision. The May Revision, before reflecting the related increase in Proposition 98 expenditures, includes a total of \$3.6 billion of revenue changes in 2011-12 and \$7.6 billion in 2012-13. After taking into account the increase in Proposition 98 expenditures, the net benefit to the budget is \$4.6 billion in 2012-13. These changes are shown in Figure REV-02. Total May Revision revenue is expected to be \$86.8 billion for 2011-12 and \$95.7 billion for 2012-13. Figure REV-03 compares, by source, the Governor's Budget and May Revision revenues.

Accurately forecasting tax revenue for a large and diverse economy like California's has always been a challenging task. That task has become even more challenging in recent years because of several factors. First, the economy is still recovering from the largest recession since the Great Depression. The recovery pattern does not conform to the patterns of other recent economic recoveries. Second, the increasing concentration of income has made tax revenues dependent to a greater degree on the income and decisions of a relatively small population of taxpayers. Third, the use of tax credits and deductions has increased in unpredictable ways. Finally, recent changes to tax laws affect how much tax is owed and when taxes are paid making it increasingly difficult to make accurate predictions based on cash receipts at any point in time.

Figure REV-01
2012-13 May Revision
General Fund Revenue Forecast
Baseline

(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 10-11:				
Personal Income Tax	\$49,491	\$49,445	-\$46	-0.1%
Sales & Use Tax	26,983	26,983	\$0	0.0%
Corporation Tax	9,614	9,614	\$0	0.0%
Insurance Tax	2,077	2,077	\$0	0.0%
Vehicle License Fees	1,330	1,330	\$0	0.0%
Estate Tax	0	0	\$0	---
Alcoholic Beverage	334	334	\$0	0.1%
Cigarette	96	96	\$0	0.0%
Other revenues	2,076	2,076	\$0	0.0%
Transfers	<u>1,488</u>	<u>1,488</u>	<u>-\$0</u>	0.0%
Total	\$93,489	\$93,443	-46	0.0%
Fiscal 11-12				
Personal Income Tax	\$51,937	\$49,803	-\$2,134	-4.1%
Sales & Use Tax	18,777	18,921	\$144	0.8%
Corporation Tax	9,479	8,208	-\$1,271	-13.4%
Insurance Tax	2,042	2,148	\$106	5.2%
Vehicle License Fees	80	70	-\$10	-12.5%
Estate Tax	0	0	\$0	---
Alcoholic Beverage	323	331	\$8	2.5%
Cigarette	93	93	\$0	0.0%
Other revenues	2,192	2,274	\$82	3.7%
Transfers	<u>1,386</u>	<u>1,390</u>	<u>\$4</u>	0.3%
Total	\$86,309	\$83,238	-3,071	-3.6%
Change from Fiscal 10-11	-\$7,180	-\$10,205		
% Change from Fiscal 10-11	-7.7%	-10.9%		
Fiscal 12-13				
Personal Income Tax	\$56,025	\$55,495	-\$530	-0.9%
Sales & Use Tax	19,595	19,997	\$402	2.1%
Corporation Tax	9,342	8,488	-\$854	-9.1%
Insurance Tax	2,179	2,089	-\$90	-4.1%
Vehicle License Fees	5	3	-\$2	-40.0%
Estate Tax	45	45	\$0	0.0%
Alcoholic Beverage	329	337	\$8	2.4%
Cigarette	90	90	\$0	0.0%
Other revenues	2,240	2,146	-\$94	-4.2%
Transfers	<u>-529</u>	<u>-554</u>	<u>-\$25</u>	4.7%
Total	\$89,321	\$88,136	-1,185	-1.3%
Change from Fiscal 11-12	\$3,012	\$4,898		
% Change from Fiscal 11-12	3.5%	5.9%		
Three-Year Total			-\$4,302	

Figure REV-02
Changes in Revenues
 (Benefit to General Fund - Dollars in Millions)

	2011-12	2012-13
Direct General Fund Impact		
Governor's initiative: Temporarily add three new PIT tax brackets for taxable incomes beginning at \$500,000 joint with rates of 10.3 percent, 11.3 percent, and 12.3 percent and a 1/4 percent sales tax	\$3,139	\$5,340
Extend the Financial Institution Records Match to Employment Development Department and the Board of Equalization	4	11
Changes to FTB wage garnishment authority	11	27
Penalty for filing a fraudulent income tax claim for refund	1	3
Other Revenue Solutions	21	128
Increase in Proposition 98 Expenditures Associated with Major Tax Changes	-	(2,908)
Transfer and Loan Solutions	395	2,043
General Fund Revenue Solutions	\$3,571	\$4,644
Other Special Fund Revenues That Offset General Fund Costs		
Extend the Managed Care Organization Taxes for Medi-Cal and Healthy Families	-	\$168
Total Net Benefit Of Revenue Solutions	\$3,571	\$4,812

From December 2010 through April 2011, revenues were running well ahead of the 2011-12 Governor's Budget forecast released in January 2011. For example, PIT estimated payments in April 2011 showed a 23.6 percent increase over the prior year. This increase in revenue led to an increase in the overall revenue forecast in the 2011 May Revision. After the release of the May Revision, cash receipts for Personal Income Tax (PIT), Corporation Tax (CT), and Sales and Use Tax (SUT) continued to come in well above forecast in May and June. In June, PIT estimated payments were up over the prior year by 20.4 percent. CT payments in June were up 20 percent over the prior year, in spite of a \$1 billion corporation tax reduction that took effect for the 2011 tax year. Receipts were so strong that an additional \$4 billion of revenue (beyond what was forecast in the May Revision forecast) was assumed in the budget. The \$4 billion additional revenue assumption was adopted along with a set of spending cuts that would be triggered in case the higher revenue did not materialize.

Figure REV-03
2012-13 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 10-11:				
Personal Income Tax	\$49,491	\$49,445	-\$46	-0.1%
Sales & Use Tax	26,983	26,983	\$0	0.0%
Corporation Tax	9,614	9,614	\$0	0.0%
Insurance Tax	2,077	2,077	\$0	0.0%
Vehicle License Fees	1,330	1,330	\$0	0.0%
Estate Tax	0	0	\$0	---
Alcoholic Beverage	334	334	\$0	0.1%
Cigarette	96	96	\$0	0.0%
Other revenues	2,076	2,076	\$0	0.0%
Transfers	1,488	1,488	-\$0	0.0%
Total	\$93,489	\$93,443	-46	0.0%
Fiscal 11-12				
Personal Income Tax	\$54,186	\$52,958	-\$1,228	-2.3%
Sales & Use Tax	\$18,777	18,921	\$144	0.8%
Corporation Tax	\$9,479	8,208	-\$1,271	-13.4%
Insurance Tax	\$2,042	2,148	\$106	5.2%
Vehicle License Fees	\$80	70	-\$10	-12.5%
Estate Tax	\$0	0	\$0	---
Alcoholic Beverage	\$323	331	\$8	2.5%
Cigarette	\$93	93	\$0	0.0%
Other revenues	\$2,213	2,295	\$82	3.7%
Transfers	1,413	1,784	\$371	26.3%
Total	\$88,606	\$86,809	-1,797	-2.0%
Change from Fiscal 10-11	-\$4,883	-\$6,634		
% Change from Fiscal 10-11	-5.2%	-7.1%		
Fiscal 12-13				
Personal Income Tax	\$59,552	\$60,268	\$716	1.2%
Sales & Use Tax	\$20,769	20,605	-\$164	-0.8%
Corporation Tax	\$9,342	8,488	-\$854	-9.1%
Insurance Tax	\$2,179	2,089	-\$90	-4.1%
Vehicle License Fees	\$5	3	-\$2	-40.0%
Estate Tax	\$45	45	\$0	0.0%
Alcoholic Beverage	\$329	337	\$8	2.4%
Cigarette	\$90	90	\$0	0.0%
Other revenues	\$2,237	2,275	\$38	1.7%
Transfers	841	1,489	\$648	77.1%
Total	\$95,389	\$95,689	300	0.3%
Change from Fiscal 11-12	\$6,783	\$8,880		
% Change from Fiscal 11-12	7.7%	10.2%		
Three-Year Total			-\$1,543	

By the time the 2012-13 Governor's Budget revenue forecast was developed, receipts for the three largest tax sources (PIT, SUT, and CT) had continued to come in at or above levels projected in the May Revision forecast through November 2011. PIT September payments were up over 8 percent, even though taxpayers are no longer required to make estimated payments in September. Historically, when cash payments come in higher than forecast, it is an indication that there is underlying strength in the revenue source above the level that had been forecast.

Just after the 2012-13 Governors' Budget forecast was developed, PIT and CT receipts started to fall off dramatically. Although receipts for the first 11 months of 2011 had shown strong growth, receipts for the months of December 2011 through April 2012 showed declines (particularly for PIT and CT) relative to the prior year. December CT estimated payments were down by 12 percent, and December/January PIT estimated payments were down by 13 percent. The drop off in tax receipts, which continued through April, led to a baseline 2012-13 May Revision forecast for 2011-12 that is \$3.1 billion lower than the Governor's Budget baseline forecast.

The 2012-13 May Revision Budget forecast for PIT and CT has dropped significantly from the Governor's Budget. Because of the reduced PIT receipts, the May Revision forecast for capital gains growth for 2011 has dropped from a 15 percent increase in January to a 5 percent decline at the May Revision. A year-over-year decline in capital gains is very atypical, other than in recessionary periods. Additionally, new 2010 tax return data suggest that the forecast for business income reported on PIT returns was somewhat optimistic. The reduction in those income items for 2010 leads to a drop in the forecast for these income items for 2011 and later years. Offsetting these declines in income are the revenues expected to be generated through the Facebook initial public offering.

For the CT, receipts have lagged significantly behind the projected and actual levels of corporate profits. It is likely that this decline is significantly due to increased usage of tax credits. The May Revision forecast for CT is down by \$1.3 billion in 2011-12 and by \$854 million in 2012-13 to reflect the weaker receipts.

The May Revision is based on the assumed passage of the Governor's tax initiative. The Governor's proposal temporarily increases tax rates on the highest income Californians, and temporarily increases the Sales and Use Tax rate by 0.25 percent. These two provisions result in a revenue increase of \$8.5 billion. The Governor's

initiative will replace some of the revenues lost in the recession as the state's economy slowly recovers.

SOLUTIONS AND POLICY PROPOSALS

The May Revision proposes the following new policy changes that will affect General Fund revenue:

- *Change rules regarding Franchise Tax Board (FTB) wage garnishment*
—The May Revision proposes to allow the FTB to issue a wage garnishment against a delinquent income tax debt without requiring FTB to record a tax lien. This provides a benefit to individuals with outstanding tax debts because it removes an incentive for FTB to record the lien. This change is expected to generate \$11 million General Fund revenue in 2011-12 and \$27 million General Fund revenue in 2012-13.
- *Penalty for fraudulent claim for refund*—Consistent with current federal law, the May Revision Budget would create a penalty for filing a fraudulent claim for refund. This penalty is intended to deter taxpayers from filing amended returns that claim credits that are not substantiated. This program is expected to generate \$1 million General Fund revenue in 2011-12 and \$3 million General Fund revenue in 2012-13.

LONG-TERM FORECAST

Figure REV-04 shows the forecast for the largest three general fund revenues from 2010-11 through 2015-16. Total General Fund revenue from these sources is expected to grow from \$86 billion in 2010-11 to \$107.7 billion in 2015-16. The average year-over-year growth rate over this period is 4.8 percent.

The May Revision economic forecast reflects modest but steady growth over the next five years. The projected average growth rate in GDP over the next five years is 2.8 percent, a slightly slower rate than normal for an economic expansion. With the exception of a decrease in the forecast of proprietors' income and national corporate profits, most key drivers of the May Revision forecast, such as total personal income, unemployment rate, wages, and the S&P 500, are projected to be slightly improved in both the short and long term over their projected levels for the Governor's Budget forecast.

Figure REV-04
Long-Term Revenue Forecast - Three Largest Sources
 (General Fund Revenue - Dollars in Billions)

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	average year over year growth
Personal Income Tax	\$49.4	\$53.0	\$60.3	\$60.2	\$67.4	\$71.4	7.7%
Sales and Use Tax	\$27.0	\$18.9	\$20.6	\$23.0	\$24.9	\$26.2	0.8%
Corporation Tax	\$9.6	\$8.2	\$8.5	\$8.9	\$9.6	\$10.1	1.3%
Total	\$86.0	\$80.1	\$89.4	\$92.2	\$101.8	\$107.7	4.8%
Growth	--	-6.9%	11.6%	3.1%	10.4%	5.8%	

The total revenue generated by these three sources has grown at an average annual rate of 5 percent since 1987. This forecast estimates a decline in General Fund revenue of 7 percent in 2011-12, followed by growth of 11.6 percent in 2012-13. Growth in 2013-14 is expected to be 3.1 percent, followed by 10.4 percent growth in 2014-15. This choppy year-to-year growth pattern, in part, reflects the expiration of temporary taxes, the dedication of sales tax to realignment in 2011-12 and the potential behavioral impact of federal tax law changes. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 reduced taxes for dividend income, capital gains, and other income. These tax reductions were set to expire after 2010. However, late in 2010 they were extended through 2012. In addition a 3.8-percent surtax on specified unearned income will go into effect on January 1, 2013, as part of federal health care financing. As was done in the Governor's Budget, the May Revision forecast assumes that in 2012 some taxpayers will respond to these rate increases by accelerating 20 percent of 2013 capital gains to 2012. It is also assumed that 10 percent of 2013 dividends and 1.1 percent of wages will be accelerated to 2012. These income shifts push revenue into 2012-13 from 2013-14, and distort the growth rate in 2014-15.

Corporate tax revenue has substantial long-term declines from the Governor's Budget forecast. This is due in part to a lower estimate of national profits both in the short and long-term along with a significant and unexpected increase in the use of tax credits.

PERSONAL INCOME TAX

The PIT forecast has been reduced by \$1.2 billion in 2011-12 and increased by \$716 million in 2012-13. Through April, current-year PIT receipts were down \$2.8 billion from the Governor's Budget forecast. April's receipts provide a clearer picture of the 2011 tax year. Based on these receipts and the overall economic forecast, it now appears that the Governor's Budget forecast overestimated the strength of capital gains income for the 2011 tax year. Because of this, the forecast growth in capital gains income for 2011 has been decreased from 15 percent growth to a 5 percent decline. Capital gains reported by taxpayers plunged 48.9 percent in 2009 and final data for the 2010 tax year shows that gains in 2010 increased 92 percent.

Offsetting the base revenue declines are an estimated \$283 million in 2011-12 and \$1.2 billion in 2012-13 from the Facebook Initial Public Offering.

This forecast also reflects the assumed passage of the Governor's tax initiative. These revenue estimates include \$3.1 billion in 2011-12 and \$4.7 billion in 2012-13 from the assumed addition of three tax brackets for taxable incomes beginning at \$500,000 for joint households (\$250,000 for single filers) with rates of 10.3 percent, 11.3 percent, and 12.3 percent for seven years.

SALES AND USE TAX

The Sales and Use Tax (SUT) forecast includes a baseline increase of \$144 million in 2011-12 and \$402 million in 2012-13.

For the current year, the SUT forecast is increased by \$144 million due to receipts through April and a stronger forecast of economic indicators, most notably lower expected unemployment rates and an uptick in expected inflation from the Governor's Budget estimates.

Overall strength in the forecast continues through 2012-13, with baseline revenues for the year up \$402 million from the Governor's Budget. This forecast assumes passage of the Governor's initiative that increases the sales tax rate by 0.25 percent from January 1, 2013, to December 31, 2016.

CORPORATION TAX

The CT forecast has been decreased by \$1.3 billion in the current year and by \$854 million in the budget year.

The decline in CT revenues in 2011-12, and 2012-13 since the Governor's Budget forecast are attributable to lower tax receipts in the current year, a lower estimate of taxable profits resulting from a lower estimate of national profits, the increased use of credits, and minor technical changes in the forecast.

Despite the fact that the May Revision economic forecast for corporate profits has been revised downward relative to the Governor's Budget forecast, national corporate profits are still expected to see healthy growth of 7.9 percent in 2011, and 1.1 percent in 2012. This growth in corporate profits does not translate to increased CT revenues in California, largely due to increased usage of credits, as well as the recently enacted legislation allowing the sharing of credits among members of the same unitary group, and allowing the elective use of single sales factor apportionment. Additionally, temporary limitations on the use of tax credits and net operating losses that were enacted in 2008 and 2010 have ended as of the 2010 and 2012 tax years respectively.

INSURANCE TAX

The insurance tax forecast has been increased by \$106 million in the current year and decreased by \$90 million in the budget year. The revenue changes are due in large part to a delay in refunds associated with a previous Board of Equalization decision on the accounting method used by insurers.

OTHER REVENUES AND TRANSFERS

The May Revision reflects a \$56.7 million increase in current year receipts from unclaimed property. The \$56.7 million consists of increased receipts in December 2011, coupled with decreased payments for claims for the same period, as compared to the estimates in the Governor's Budget. Including the unclaimed property revenue increase, the May Revision includes \$21 million in minor revenue solutions for 2011-12 and \$128 million for 2012-13. The May Revision proposes an increase in loan and transfer budget solutions of \$367 million in 2011-12 and \$673 million in 2012-13, which includes new transfers and extensions of repayment dates for loans. In total, the May Revision includes \$395 million in loan and transfer solutions for 2011-12 and \$2 billion for 2012-13.

2011 REALIGNMENT REVENUES

The 2011 Realignment is funded by a portion of the SUT rate as well as by a portion of the Vehicle License Fee (VLF). The May Revision forecasts that the 1.0625% of the SUT rate that is dedicated to the 2011 Local Revenue Fund will contribute \$5.2 billion in 2011-12 and \$5.4 billion in 2012-13. The 2011 Realignment portion of the VLF is estimated at \$462 million for 2011-12 and \$496 million for 2012-13. The sales tax estimates are increased by \$46 million in 2011-12 and \$115 million in 2012-13 above the Governor's Budget levels.

PROPERTY TAX

Article XIII A of the State Constitution (Proposition 13) provides that property is assessed at its 1975 fair market value until it changes ownership. When ownership changes, the assessed value is redetermined based on the property's current market value. New construction is assessed at fair market value when construction is completed. A property's base year value may be increased by an inflation factor, not to exceed 2 percent annually.

Although the property tax is a local revenue source, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools typically offset General Fund expenditures. Assessed value growth is estimated based on twice-yearly surveys of county assessors and evaluation of real estate trends. Declines in sales volumes and prices in 2010, coupled with declines in property values and failures to remit property tax payments as a result of mortgage defaults and foreclosures, negatively impacted assessed values and property tax levies in 2011-12 to an extent that was greater than anticipated at Governor's Budget. While those trends moderated somewhat in 2011, the declines in sales volumes and prices were still significant enough to reduce the estimated 2012-13 growth rate from the level estimated in the fall. Property tax collections are estimated to decrease 0.4 percent from 2010-11 to 2011-12, which is a decline from the positive 0.5 percent growth rate forecast at Governor's Budget. The 2012-13 property tax growth rate is estimated at 0.5 percent, which is down from the 0.7 percent estimated in the fall.